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The German Investment Tax Act- The Big Reform is Coming Closer

7 February 2017, KPMG Luxembourg

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Introduction
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The Big Reform is Coming Closer – Current Status and Outlook
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Closing & Q&A

Brunch

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German Reform of Investment Taxation

Andreas Patzner / Stefan Schmidt
KPMG Frankfurt
07 February 2017

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Changes to the Investment Tax Act (InvStG) and the Income Tax Act (EStG)

Corrections of Tax Figures from 2018 onwards

Correction of German tax figures according to § 5 Abs. 1 Nr. 5 Satz 4 InvStG n.F.

Publications of tax figures till 31.12.2017

— Ex-nunc, i.e. the correction amounts are added or offset from the respective tax figures of the next fund business year (31.12.2017 as a last correction chance!)

Publications from 1.1.2018 onwards

— Publication of the correction amounts and the business year they belong to

— Deemed to be received by the German investors on the publication date

— Deemed to be received by those German investors who originally received the incorrect German tax earnings

Corrections of Tax Figures from 2018 onwards

Correction of German tax figures according to § 5 Abs. 1 Nr. 5 Satz 4 InvStG n.F.

Example:

Publication of 28.4.2017 for 31.12.2016: Interest Earnings are by 0,10 EUR too low -> Positive Interest Correction Amount of 0,10 EUR per fund unit in the publication for 31.12.2017 in the year 2018 (last correction chance!)

Example 2:

Publication of 28.4.2018 for 31.12.2017: Interest Earnings are by 0,10 EUR too low -> Separate publication of the positive interest correction amount of 0,10 EUR per unit when the mistake is noticed and taxable inflow of that correction amount received by the investors who held the fund units on 31.12.2017 taxable in that tax year during which the publication of the correction amount is made.

Example 3:

Publication of 28.4.2005 for 31.12.2004: Interest Earnings are by 0,10 EUR too low -> Separate publication of the positive interest correction amount of 0,10 EUR per unit when the mistake is noticed in the year 2030 and taxable inflow of that correction amount received by the investors who held the fund units on 31.12.2004; taxable in that tax year during which the publication of the correction amount is made (e.g. 11.11.2030).

Changes to the InvStG

- **Adaptation of the certificate text** pursuant to Section 5(1a) InvStG
  - The certificate issued by the professional must contain a statement

    whether "indications have been found that structures of the investment fund have served tax evasion in terms of § 42 German Tax Code and have influenced the certified year end tax figures or the equity gain during the certified fund business year"
  - valid from entry into force up to reform
- A professional commits **a regulatory offence and can be punished with an administrative fine of up to EUR 50,000** if they
  - certify despite **errors** that the bases of taxation have been determined in accordance with the rules of German tax law
  - do not provide **any information on structures**
- Possibility of furnishing proof of bases of taxation for previously non-transparent EU funds -> especially by certification of the professional pursuant to Section 5 InvStG
- **Extension** of the transitional regulation pursuant to **Section 22(2) InvStG** to **31 December 2017**: funds within the meaning of the InvStG as amended on 21 July 2013 that do not fulfil the requirements of Section 1(1b) sentence 2 InvStG as amended by the AIFM-StAnpG are regarded as investment funds until reform
- valid from entry into force until reform

Changes to the EStG

Section 36a EStG (application already from 1 January 2016 onwards)

- The crediting of the income tax collected by tax deduction to dividends from shares and profit participation certificates in collective safe custody is excluded if
  - within a period of **45 days before and 45 days after** the maturity of the dividend
  - of less than **45 days**
  - is the **economic and civil owner** of the shares or profit participation certificates
  - Days on which the taxpayer bears less than 7**0% of the risk of a change in value** from the fair value upon acquisition of the shares or profit participation certificates and also the **day of disposal** are not to be included in the minimum holding period
- Taxpayers for whom no tax deduction has been conducted or who have been refunded a tax deduction and who do not satisfy the requirements are required:
  - **to notify** this to their competent tax office and
  - **to make a payment** in the amount of the outstanding tax deduction
- This does **not apply** if

1. the capital income in the assessment period amounted to no more than EUR 20,000 or
2. the taxpayer has been the economic and civil owner of the shares or profit participation certificates for at least one year upon accrual of the dividend

Extention for foreign entities planned under the German Anti-BEPS-Act, however, as Luxembourg funds suffer at least 15 % German withholding tax anyhow, this would have no big impact for funds

Development of and background to the reform

Development

- 03/03/2011 — Conference of finance ministers: Bund-Länder-Arbeitsgruppe (BLAG – Federal-State Working Group) commissioned to develop proposals for restructuring investment tax at the initiative of Hesse
- 12/12/2011 — First submission, draft report on the restructuring
- 25/01/2012 — Hearing of associations
- 24/02/2012 — 2nd draft report (extensively revised)
- 02/03/2012 — Sending to the associations with opportunity to comment: proposals on solutions within the existing system and fears of negative effects on the capital market and pension system
- 01/06/2012 — Conference of finance ministers: decision to commission an expert economic report
- Autumn 2014 — Submission of expert report from Copenhagen Economics
- 2014 — Agreement on fundamental reform of investment tax (in coalition agreement)
- March 2015 — Draft discussion as of 27 January 2015 circulated
- 18/05/2015 — BLAG advises draft discussion
- 21/07/2015 — Revised discussion draft sent to the associations for comment
- 17/12/2015 — Draft bill sent to the associations for comment

Development

24.02.2016	Government Draft
11.03.2016	Notification of the German Federal Counsil
22.04.2016	Detailed Comment of the German Federal Counsil
09.05.2016	Public Hearing of the Finance Commitee of the Federal Parliament
08.06.2016	Final Consideration of the Finance Commitee of the Federal Parliament
09.06.2016	2nd and 3rd Reading in German Federal Parliament
08.07.2016	2nd Consideration of the German Federal Counsil
26.07.2016	Publication of the law
01/01/2018	Entry into force

Background

1. Rectification of risks under EU law

- ECJ case law on the different tax treatment of dividend income on the fund input side
  - ECJ ruling of 10 May 2012 in the FIM Santander case (cases C-338/11 and C-339/11 to C-347/11)
  - ECJ ruling of 10 April 2014 in the Emerging Markets case (case C-190/12)

2. Reduction of structural vulnerability

- Because of the complexity and the high asset volumes, the Investment Tax Act is particularly vulnerable to tax structures
  - Creation of withholding tax refund claims as a result of short sales across the dividend record date (cum-ex structures)
  - Avoidance of taxation of dividends (cum-cum structures)
  - Increase in the fund equity gains as a result of tie-in (combination) transactions
  - Avoidance of deemed distributed income through financial derivatives
  - Income equalisation models
- Previous selective corrections not sufficient in the view of the tax authorities: vulnerability to structures can be reduced only through a change in the system

Background

3. Reduction of complexity

- High administrative expense in practice
- 33 different bases of taxation in case of each distribution or deemed distribution
- 12+ loss offsetting categories
- High costs for determining the bases of taxation (approximately EUR 50 million p.a.)
- Bases for taxation not verifiable for investors or the tax authorities (in practice data is in fact taken over unchecked)
- Need for change as a result of ECJ ruling of 9 October 2014 in the van Caster/van Caster case (case C- 326/12)

4. Correction of system errors

- No retrospective correction of errors possible with mutual funds
- Errors are corrected, after differences that have been discovered cannot be appealed, in the current financial year of the mutual fund (i.e. error correction partly to the detriment of new investors)

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Scope of the new Investment Tax Act

Scope of the new Investment Tax Act (InvStG-E)

- Investment funds within the meaning of Section 1 (1) of the Kapitalanlagegesetzbuch (KAGB – German Capital Investment Act); distinction between UCITS and AIF no longer required
- Sub-funds continue to represent independent investment funds for tax purposes
- In addition to the "investment funds" within the meaning of the KAGB, the following also fall under the InvStG-E:
  - Single-investor investment funds
  - Asset managing limited companies not subject to taxation: Luxembourg family asset management company, SPF (société de gestion patrimoine familial)
  - Group's own AIFs
- Continued divergence of supervisory and tax law
- The following do not fall under the scope of the InvStG-E:
  - Investment funds in the legal form of a partnership (exceptions: UCITS within the meaning of Section 1 (2) KAGB and pension plan asset funds)
  - Associated companies pursuant to Section 1a (1) no. 1 of the Gesetz über Unternehmensbeteiligungs-gesellschaften (UBGG – Associated Companies Act) and certain capital investment companies
  - REITs
- Investment provisions continue to be complied with only by special investment funds

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Tax regime

Overview

Non-transparent regime

- For **mutual investment funds**
- Concept of investment fund defined more broadly than in previous InvStG: now also includes capital investment companies
- No more transparency, but taxation as "income from investment funds within the meaning of Section 20 (1) no. 3 and no. 3a EStG-E"
- No Section 5 InvStG certification
- No valuation daily tax figures
- (Domestic and foreign) **funds** subject to corporate income tax of 15% on domestic equity income and domestic real estate income
- Taxation of all other income (interest, foreign dividends, gains on disposals, forward transactions) of **investor** in the event of distribution or deemed distribution
- Distributions **fully liable to tax (flat taxation)** by law
- **Deemed distributions** are taxed through **advanced lump sum** (0.77% for 2016) at the investor (maximum annual appreciation)
- For **"equity funds" exemption** of 30% (PV)/60% (BV EStG)/ 80% (BV KStG) at a minimum equity share of 51%
- For **"mixed funds" exemption** of 15% (PV)/30% (BV EStG)/ 40% (BV KStG) at a minimum equity share of 25%
- For (open-ended) **"real estate funds":** generally an exemption of 60% (mainly foreign real estate: 80%)
- Grandfathering cap for shares acquired before 2009

Transparent regime

- For **special investment funds**
- Conditions
  - Directly/**indirectly** max. 100 investors
  - No natural persons or asset management partnership as investors (with exceptions and transitional introduction periods)
- Withholding tax on German dividends and German real estate income at input level. With the **transparency option** this can be offset at investor level or can be reimbursed
- Taxation of all non-distributed capital gains after **15 years**
- **Pro rata calculation** of the basis of taxation
- Calculation of valuation daily tax figures: equity gains, real estate gains **+ partial exemptions**
- Otherwise retention of the existing system with modifications

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Non-transparent tax regime – mutual funds

Comparison

Current law

- **Domestic** investment funds are fully exempt from corporate income and trade tax
- **Foreign** investment funds are subject to the limited tax liability pursuant to Section 49 EStG
- Domestic dividends and domestic property income are basically taxable

  = rental/lease income from domestic properties as well as gains from the disposal of domestic properties within the ten-year period of section 23 (1) no. 1 EStG
- Corporate income tax rate 15%

Investment tax reform

- Domestic and foreign investment funds are subject to the same taxation facts within the meaning of Section 49 EStG
- Domestic dividends and domestic property income are basically taxable

  = rental/lease income from domestic properties as well as generally gains from the disposal of domestic properties, i.e. also outside of the ten-year period of Section 23 (1) no. 1 EStG
- Corporate income tax rate 15% (certificate needed)
  - Exemption for certain investors (churches, foundations)
  - Tax exempt share classes
- Trade tax exemption is continued

Comparison

Current law

Determination of the bases of taxation

There are 11 income categories to be distinguished, which have to be shown separately from each other, i.e. offsetting of losses and income is not permitted in this regard; if necessary, 11 loss carryforward pools have to be created:

- In the case of deemed distribution of taxable income types without dividends and without REIT-dividends (especially interest, rental income [if these are not tax-exempt on the basis of a double taxation agreement], gains on disposal from "financial innovations", profits from the sale of domestic properties within a ten-year retention period)
- Domestic dividends
- Foreign dividends
- Domestic REIT-dividends
- Foreign REIT-dividends
- Grandfathered gains on disposals that are **not** subject to the half/partial income method
  (securities [excluding shares] that were acquired before 2009)
- Grandfathered gains on disposals that are subject to the half/partial income method
- New gains on disposals that are **not** subject to the partial income method (these include especially gains on disposals of securities that are not equities and profits from forward transactions)
- New gains on disposals that are subject to the partial income method (= gains on disposals of equities)
- Income that is tax-exempt on the basis of a double taxation agreement (generally foreign real estate income)
- Domestic real estate income pursuant to Section 7 (3) sentence 1 no. 2 InvStG

Investment tax reform

No determination of the bases of taxation necessary

Instead:

- **Distribution**
  The full amount of the distribution is taxable

- **Advance lump sum**
  If the mutual investment fund does not distribute or distributes only a small amount, an advance lump sum is collected. The amount of the advance lump sum is determined by the value of the fund share at the beginning of the calendar year multiplied by a variable base rate calculated annually by the Bundesbank less a 30% discount

  [Base rate 3.43% (2011); 2.44% (2012); 2.04% (2013); 2.59% (2014); 0.99% (2015); 1.1% (2016)]
  The collection of the advance lump sum is capped by the actual appreciation of the fund share

- **Partial exemption**
  The following are tax-exempt for
  - equity funds (= more than half of the asset consists of equities) **30% (PV), 60% (BV EStG), 80% (BV KStG)**
  - mixed funds (= more than 25% of the asset consists of equities) **15% (PV), 30% (BV EStG), 40% (BV KStG)**
  - Real estate funds with predominantly domestic properties **60%**
  - Real estate funds with predominantly foreign properties **80%**

Comparison

Current law

- In the case of a disposal of foreign deemed distributing investment funds and in the case of investment funds that do not publish bases for taxation, domestic financial institutions have to conduct a **catch-up deduction of the withholding tax** retroactively for the entire holding period In an extreme case, the basis of taxation can be higher than the entire sale proceeds

- Calculation scheme for determining the gain on disposal

Sale proceeds
- Acquisition costs
+ Interim profits upon acquisition
- Interim profits upon sale/redemption
- Deemed distributed income already taxed
+ Deemed distributed income already taxed if these have been distributed tax-free in the following years
- Lump sum amounts already taxed
+ Grandfathered gains on disposals distributed tax-fee (only in the case of private investors)
+ Foreign tax paid
+/- Gains that are tax-free on account of double taxation agreement
+/- Equity gains (only in the case of specific institutional investors)
= Basis of assessment for tax purposes

Investment tax reform

- The catch-up deduction of withholding tax **ceases to apply**

- Calculation scheme for determining the gain on disposal

Sale proceeds
- Acquisition costs
- Advance lump sum already taxed
= Basis of assessment for tax purposes

if applicable **partial exemption** (for equity funds 30%, mixed funds 15%, real estate funds 60% or 80% (PV))

Comparison

Current law	Investment tax reform
■ **Interim profits** are interest that has accrued to the investment fund up until the share has been acquired or sold (corresponds to accrued interest in the purchase/sale of bonds) ■ **Deemed distributed income** consists of certain types of income that are also taxable in the event of no distribution (= reinvestment). The deemed distributed income is deemed to have accrued to the investors at the end of the financial year of the investment fund. This income that has already been taxed is to be deducted in the event of disposal. ■ **Lump sum amounts** are the bases for assessment that are recognised when an investment fund does nor publish any bases for assessment. These amounts that have already been taxed are to be deducted in the event of disposal. ■ **Grandfathered gains on disposals** are profits from the sale of securities that were acquired before 2009 (portfolio protection upon the introduction of the flat-rate withholding tax). The grandfathered gains on disposals may be distributed tax-free. If the investor acquired an investment share after 2009, they do not come under the grandfathering regulation, with the result that the tax-fee distributions are corrected upon disposal. ■ The **foreign tax paid** has already been taken into account for the purpose of reducing tax in the annual/current taxation. In order to avoid a double tax reduction being taken into consideration, it is to be added to the gain on disposal. ■ **Profits that are tax-exempt on account of a double taxation agreement** (foreign real estate income) and that have not been distributed to the investors yet reduce the taxable gain on disposal. ■ **Equity gains** are profits or losses that the investment fund has generated from the disposal of equities or from price gains or losses on equities resp. dividend income from equities. They must be indicated separately in order for Section 3 no. 40 EStG or Section 8b KStG to be applied to the investor.	All items of current legislation on calculating the gain listed on the left **cease to apply**.

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Application and transitional regulations

Application and transitional regulations

- Entry into force: **1 January 2018**
- Investment funds have to create a **short** (tax) **financial year** if they have a financial year diverging from the calendar year at 31 December 2017
- Uniform transition for all investment funds and all investors to the new law
- On account of the regulation on short financial years, the effort for determining/checking the bases for taxation and for auditing these would be concentrated in the first quarter
  - **Extension of deadline** for the publication of the bases of taxation from four to **twelve months** (up to 31 December 2018)
  - Deadline for the resolution on distribution extended from four to **eight months**
- Shares in investment funds and capital investment companies are regarded as **sold** at the close of 31 December 2017 and **acquired** at the start of 1 January 2018
- The last redemption price determined in the 2017 calendar year is regarded as the proceeds on disposal (alternatively stock exchange or market price)
- The gain/loss on notional disposal to be taxed only in the event of **actual sale** by the investor (tax deduction according to Section 43(1) sentence 1 no. 9 EStG) → upon partial sale FIFO
- The gain/loss is to be **determined separately**: declaration of the investor to be submitted to the tax office by 31 December 2021

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Application and transitional regulations

- If the acquisition data necessary for determining the notional disposal is not available, a **substitute basis of taxation** of 30% of the last redemption price determined in 2017 (alternatively stock exchange/market price) is to be recognised
  - Assessment obligation on the basis of the actual acquisition cost (deduction has not compensation effect)
  - In divergence from Section 43a(3) sentence 4 EStG, the issuance of a tax certificate to be is mandatory
  - Otherwise gain estimation by the tax office
- ADDI and interim profits are subject to the tax deduction pursuant to Section 43(1) sentence 1 no. 5 EStG at the time of the actual disposal of the old shares
- Custodian institutions that hold old shares in custody have to calculate the profit from the notional disposal by **31 December 2020** and to keep it until the actual disposal

Application and transitional regulations

- **Transitional regulations for "old" private investors**
  - In principle portfolio protection, as acquired before 1 January 2009 (granting as part of the introduction of the flat-rate withholding tax)
  - Portfolio protection time limit on disposals up to 31 December 2017 (for acquisitions before 1 January 2009)
  - **Change in value (appreciation) from 1 January 2018** will be recorded for tax purposes in the event of later disposals. However an **exemption amount totalling EUR 100,000** is granted (only for shares held as private assets that were acquired before 2009), with the result that the gains on disposal accruing from 2018 onwards continue to be tax-free
  - The exemption amount remaining at the end of the assessment period is to be **determined separately** by the tax office competent for the income tax of the investor on an annual basis for the investor until the exemption amount has been fully utilised.
  - An exemption amount that has already been "used up" is restored if losses are incurred in a subsequent assessment period from investment shares acquired before 2009.
  - In the event of losses in a subsequent period, the determination of the utilisation of the exemption amount must be updated.

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Case Study

Public-Investmentfunds

Example

On 1 April 2018 investor X buys shares of a stock fund (at least 51% stocks)

On 5 July 2018 the fund pays out 10€ per share

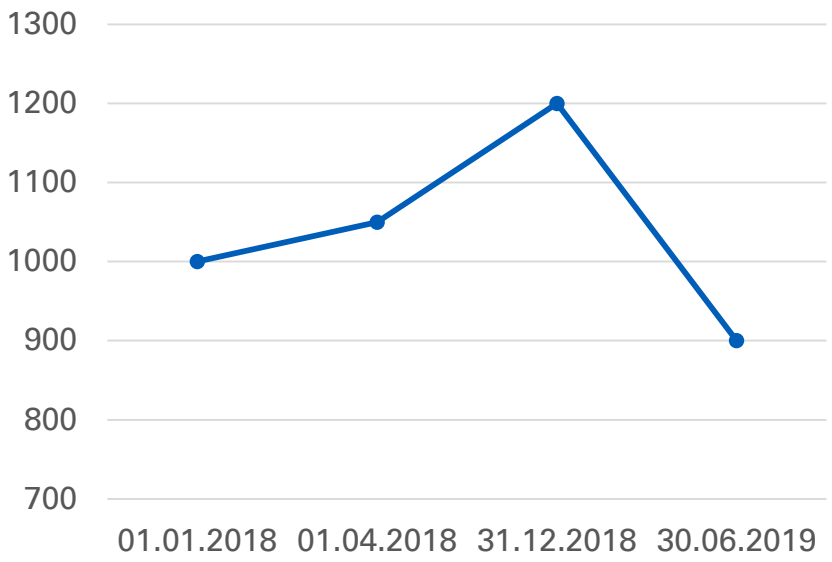
On 30 June 2019 investor X sells his shares

In the year 2018 the base rate is 2% according to §14 (3) Investmant Tax Act

What are the consequences for the

- Capital management company,
- Custodian bank, and
- Investor?

Price of the fund in the respective time period



Public-Investmentfunds

Example

1 April 2018: Purchase of shares of a certain fund at a price of 1,050 EUR per share

CMC: No calculation of daily tax numbers (interim profit abolished)

Custodian bank: No consideration of interim profits in income statement

Investor: No consideration of daily tax numbers (interim profit abolished)

Public-Investmentfunds

Example

5 July 2018: The fund pays out 10 EUR per share

CMC: Payout-decision and payout
No calculation of taxable amount
No detailed WM-notifications

Custodian bank: Pays attention to classification of fund
Applys partial exemption rate (PV)
Withholds withholding tax and pays it

Investor: Domestic deposit: to private investors tax acts as a payment (so-called withholdig tax), to other investors it is only an advanced payment
Foreign deposit: Obligation to declare payout in tax assessment

Example

Type of investor	Payout (EUR)	Partial exemption (custodian bank)	Withholding tax (EUR)	Partial exemption (assessment)	Taxable amount (EUR)
PV, LV, KV, KI, FDL, FU	10.00	30 %	1.75	30 %	7.00
BV EStG	10.00	30 %	1.75	60 %	4.00
BV KStG	10.00	30 %	1.75	80 %	2.00

Investor: Partial deduction of costs which are econonomically tied to the investment income

Partial exemption rates for income tax/ corporate tax

Example

2 January 2019: Fictitious inflow of advanced lump sum

CMC: Domestic fund: No tax liquidity => Passes on withholding tax process to custodian bank

Custodian bank: Investor classification must be recognized (life/ health insurance?)
Has to recognize fund classification
Applys partial exemption (PV)
Determines date of purchase to calculate proportionate advanced lump sum
Withholds withholding tax and pays it

Investor: Taxation of fictitious inflow of advanced lump sum
Foreign deposit: Obligation to declare advanced lump sum in tax assessment
Partial deduction of costs which are economically tied to the investment profits

Keep in mind: Varying advanced lump sums for the same kind of fund shares in case of different purchases within the year
Absence of liquidity -> §44 subpar. 1 sentence 8 EStG: Charge of bank account (preceding objection)

Example

	(First) redemption price at the beginning of the calendar year	**1,000 EUR**
x	base rate 2 %	
x	0,7 (= 30 % lump sum)	1.4 %
=	**basic income**	**14.00 EUR**
./.	1/12 per full month before the purchase on 1 April 2018	3.50 EUR (3/12 x 14) !
./.	payout wihin the year	10.00 EUR
=	**advanced lump sum (fund level)**	**0.50 EUR**
	maximum increase in value (plus payout)	210 EUR
x	partial exemption	30 % / 60 % / 80 %
=	**advanced lump sum (investor PV, KI, FDL, FU / BV EStG / BV KStG)**	**0.35 / 0.20 / 0.10 EUR**

Public-Investmentfunds

Example

30 June 2019: Investor sells his shares at a price of 900 EUR per share

CMC: No calculation of daily tax numbers (no more interim profit/ equity gain)

Custodian bank: Calculates capital gains (900 ./. 1,050 = ./. 150)
Deducts proportionate advanced lump sums (./. 0.50 EUR)
Taxable capital gains: -150.50 EUR
Investor classification important (PV etc.)
Fund classification important
Applys partial exemption
Determines withholding tax, and pays it (in case of loss regards it in profit loss statement)
Withholding tax rules according to §43 subpar. 1 No. 9 EStG are to be used

Investor: **Taxation of advanced lump sum on 2 January 2019 although he generated an overall loss!**

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Action Points

Immediate Action required for all kind of investment funds

- **45 Day Rule 2017: Process for corporate income tax reclaim for funds with tax exempt investors** § 36a EStG
- **45 Tage Regel 2017: Fund management for funds with tax exempt investors** § 36a EStG
- **New Definition of a (Retail-)Investment Fund, delete German specific investment restrictions** § 1, 24 InvStG
- **New German Tax Investment Guidlines for (Retail-)Investment Funds which shall be eligible for investment by Special Investment Funds** § 26 Nr. 4h InvStG
- **Investment Restrictions for Partial Exemption (Stock Funds / Mixed Funds / Real Estate Funds with German or foreign investment focus) to be implemented in documenation and to be monitored** § 2, 20, 22 InvStG
- **Corporate Income Tax Liability of the investment fund for German dividends and German source real estate income and -gains** § 6, 29 InvStG
- **Frequent application for investment fund status certificate (Statusbescheinigung)** § 7, 55 InvStG
- **Specific processes to apply partial corporate income tax exemption of fund in case of exempt investors** § 8, 9, 11, 12, 14 InvStG
- **Specific processes to be implemented in case of funds / classes with exempt investors only** § 10, 11, 12, 13, 14 InvStG
- **Reporting of fund status, redemption prices and other information to WMDaten** § 18 InvStG et al
- **Transition to new taxatoin system, 31 December 2017 task** § 56

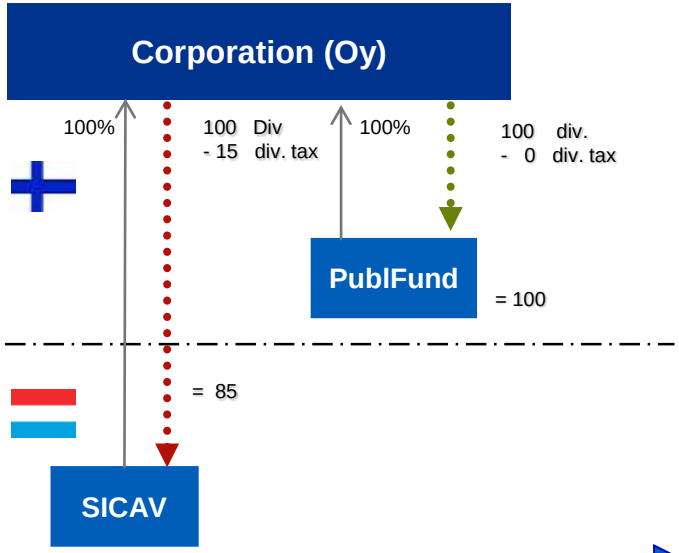
VI. EU Law Developments concerning the German Investment Tax Reform Act 2018

Agenda

I	Discriminatory German withholding tax on German dividends paid to foreign funds („Aberdeen-/Santander- refund claims“) until 31 Dec 2017 (tax exemption of §11 InvStG for German investment funds)
II	Current status quo of our model case linked to the „Aberdeen-/Santander- refund claims“ in Germany (procedure, questions of jurisdiction, consequences for foreign investors)
III	„Cum-Cum-Deals“, as unlawful deals according to §36a EStG
IV	Discriminating factors of the dividend tax according to §6 InvStG 2018, compared to the foreigner car toll claims according to §20 InvStG 2018

I. Discriminatory German withholding tax on German dividends paid to foreign funds („Aberdeen-/Santander- refund claims") until 31 Dec 2017 (tax exemption of §11 InvStG for German investment funds)

1. ECJ from 18 June 2009 C-303/07 Aberdeen Property Invest



Issue

A Finnish fund was exempted from corporate taxes and thus could earn dividends from finnish corporations without paying a corporate tax on those dividends.

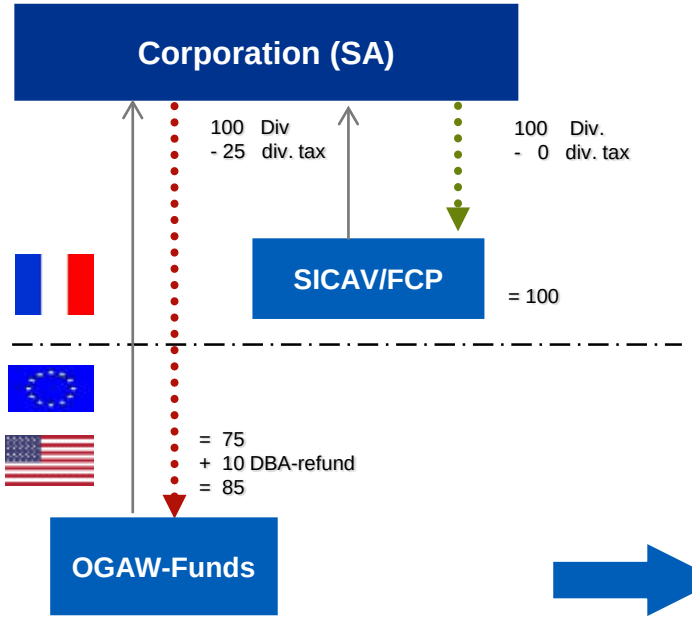
Luxembourger investment corporations (SICAV) on the other hand had to pay 15% in dividend taxes.

Ruling

Dividend taxes solely on foreign but otherwise equal funds offend the freedom of establishment (Art. 49 EG, now Art 43 AEUV)

Discrimination: 15

2. ECJ from 10 May 2012 C-338-347/11 FIM Santander and others



Issue

A French fund could earn dividends from French companies without paying a dividend tax.

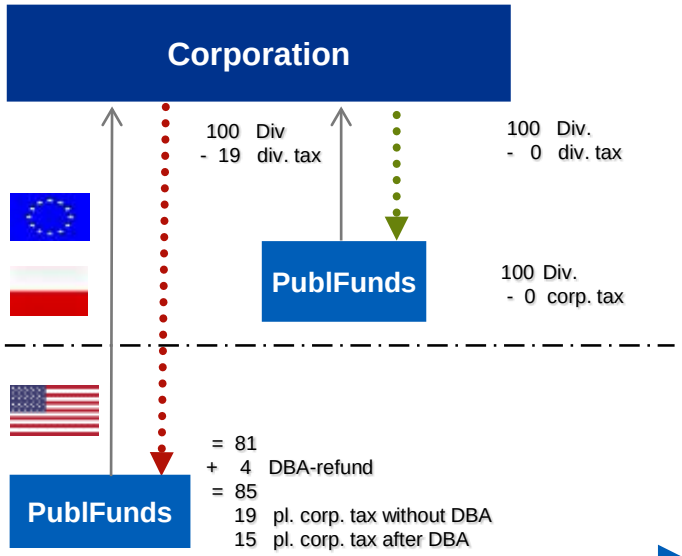
French dividends earned by funds in other EU countries or the US (if not eligible for a lower rate according to a DBA-ruling) were reduced by a 25% French dividend tax

Ruling

The dividend tax explicitly targeting foreign funds violates the freedom of capital transactions (Art. 63 AEUV).

Discrimination: 25/15

3. ECJ from 10 April 2014 C-190/12 DFA Emerging Markets



Issue (simplified)

Corporate tax exempted polish funds could earn dividends from polish corporations without paying a dividend tax respectively.

Foreign funds' dividends were taxed with a 19% or 15% (if DBA eligible) dividend tax.

After being sued for breaching contracts Poland exempted all EU funds from paying a dividend tax on their dividends.

Ruling

Taxing solely dividends received by third countries (non-EU countries) violates the freedom of capital transactions (Art. 63 AEUV).

Discrimination: 19/15

4. Situation in Germany

Conclusion by the German Federal Audit Court for 2015:

- **Withholding taxes on dividends received by foreign funds and corporations explicitely violate the freedom of capital movement**

- **2 billion € in dividend taxes** per year **= 20 billion €** since 2005 +
- **120 Mio. € interest** per year **= 1,2 billion €** since 2005 (interest deficit)

- Responsible Tax Office: The local finance authority in whose jurisdiction we find the most valuable investments of our client -> main finance authority according to § 20 subparagraph 3 AO.
- Unclear responsibility of tax authorities used to be an obstacle for a test case (risk of test case failor due to wrong tax office)
- Eliminating the discrimination through the InvStG reform coming in 2018 does not eliminate any discriminating actions that occured before 2018

4. Situation in Germany

-> Conclusion by the German Federal Audit Office (Bundesrechnungshof)

- Only the legislator can create central tax office responsibility
- Federal states demand central responsibility of the Federal Tax Office for many years now
- Federal Government suggests reviewing the proposal
- The establishment of a central authority / responsibility of the Federal Tax Office has failed so far because of questions regarding who will bear the tax- (and interest-) deficits: The states (Länder) or the Federation (Bund) of Germany

-> Recommendations in case a tax on dividends had to be paid before 2018:

- **Launch a refund claim with every potentially responsible finance authority„asap.“**

-> Statue of limitations / limitation period uncertain: Launch claims for all years with substantial dividends

4. Situation in Germany

-> Local Tax Authority‘s jurisdiction

- The local tax authority in whose jurisdiction we find the most valuable investments of our client -> main finance authority according to § 20 subparagraph 3 AO.

  -> Difficult to determine!

-> Statue of limitations

- Time limit of 4 years according to § 32 subparagraph 5 KStG 2013 indicating potential deadline?

  -> Prolonged time limits based on the principle of equivalence possible!

-> Further uncertainties

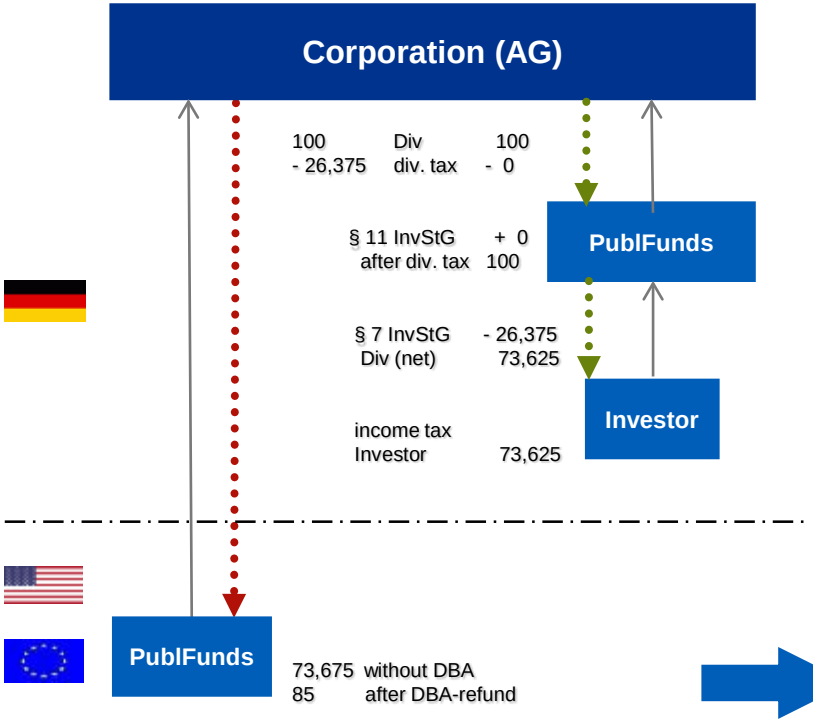
- Claims on fund or on subfund level?
- Criteria for the comparability of a foreign investor with a specific tax exempt German investors in the light of freedom of capital movement (Rechtstypenvergleich)?
- Required information and paperwork?
- Claims only possible by the investor himself or power of attorney feasible?

4. Situation in Germany

„Model Case“ by KPMG (see also II):

- Fokus-/Aberdeen-/Santander-claims are currently not being processed by tax authorities
- Federal Ministry of Finance (BMF) desires ECJ ruling on EU law compatibility of §11 InvStG
- Feder Ministry of Finance (BMF) – in contrast to the Federal Audit Authority (BRH) – considers tax exemption according to §11 InvStG (until 2017) to be in conformity with EU-law because it is connected to §7 InvStG, which states that (deemed) fund distributions received by the investor can be subject to output withholding tax („Santander-ruling“ of coherency?)
- No justification through coherency arguments, provided that the ECJ supports ist current ruling that coherency has to exist on the level of the same tax payers
- Uncertainty in German tax office responsibility prevented Fokus-/Aberdeen-test case so far
- Eliminating uncertainty in tax office responsibility by competency agreements in terms of §27 German Tax Code (AO).

4. Situation in Germany



Issue

Domestic public funds receive their full dividends because of §11 InvStG, but have to pay a dividend tax on other payouts and same value payouts because of §7 InvStG.

Since tax exemption (§11 InvStG) does not apply to foreign investors, they have to pay a definitive German dividend tax of 26% (without DBA) or 15% (with DBA).

Consequences

Constraint indisputable. The financial administration views the EU law ("coherent tax system") as justification to link the tax exemption according to §11 InvStG to the collection of a dividend tax according to §7 InvStG.

Discrimintation: 26/15
justification (coherence)?

4. Situation in Germany

Outstanding rulings on the following by the ECJ:

- Difficulties in determining the competent tax authority (§20 subparagraph 3 AO)
- Application of the freedom of capital movement for third country (non-EU) investors due to the „standstill“-clause (Art. 64 subparagraph 1 AEUV) -> dividend tax (= constraint §§43 ff. EStG) existed on 31 December 1993– connection to financial services?
- Justification of cross-border-allocation of the taxation compentence: ECJ has dealt in 32 (out of 249) decisions concerning the direct taxation with that argument while always assuming that this justification does only apply in case of a real taxation of the local investor

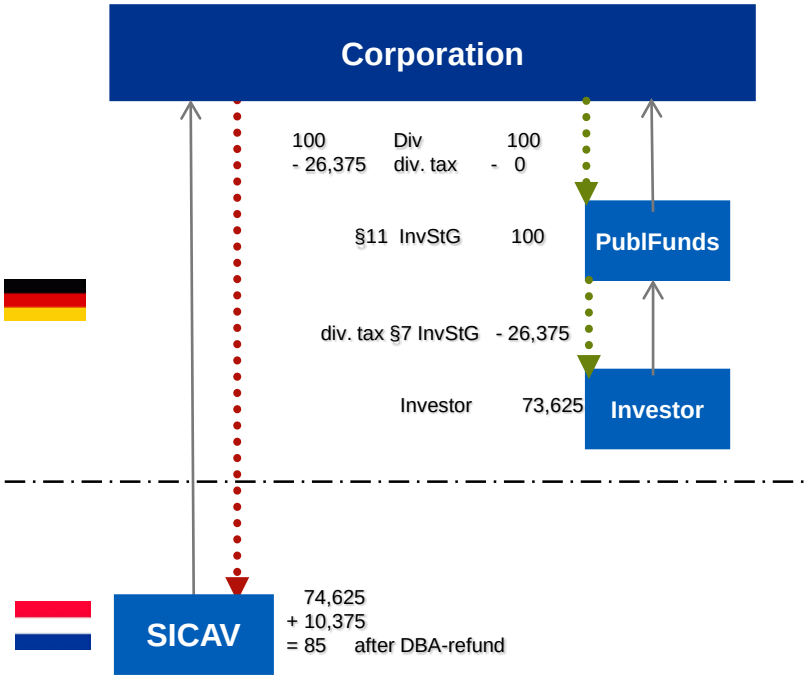
4. Situation in Germany

Outstanding rulings on the following by the ECJ:

- Argument of Coherency of the German tax system: ECJ has dealt in 82 (out of 249) decisions concering the direct taxation with that argument while linking coherence to identity of tax payer (i.e. the taxable advantage and thus the coherent disadvantage has to occur with the same person)
- Statue of limitations (4, 7, 10, or 13 years because of EU-wide principle of equivalence)?
- Collection of interest payments according to §233 AO with 6% p.a. (even if in case of domestic refunding a withholding tax would not generate interest payments)?

II. Current status quo of our model case linked to the „Aberdeen-/Santander-refund claims" in Germany (procedure, questions of jurisdictions, consequences fo foreign investors)

1. Finance Court Hessen (pending on Az. 4 K 2079/16)



Issue

After receiving an 11.375 % DBA-refund the LU SICAV sues for further refunds on 15% of their dividend taxes for the years 2009 – 2013 in addition to 6% interest (§ 233a AO).

Claims were made with the Federal Central Tax Office, the finance authorities WI (Clearstream), M, LEV, and HH in 2013 (§ 20 III AO).

After establishing a jurisdiction declaration(§27 AO) the finance authority V in Frankfurt became the defendant.

Finance Court Hessen seeks ECJ template art. 267 subparagraph 2!

Court rulings to be determined:

Coherence as EU-wide justification?

Interest payments on refunds according to §233a AO?

Constraint: 15
No justification through coherence!

2. Finance Court Hessen (pending on Az. 4 K 2079/16)

Consequences

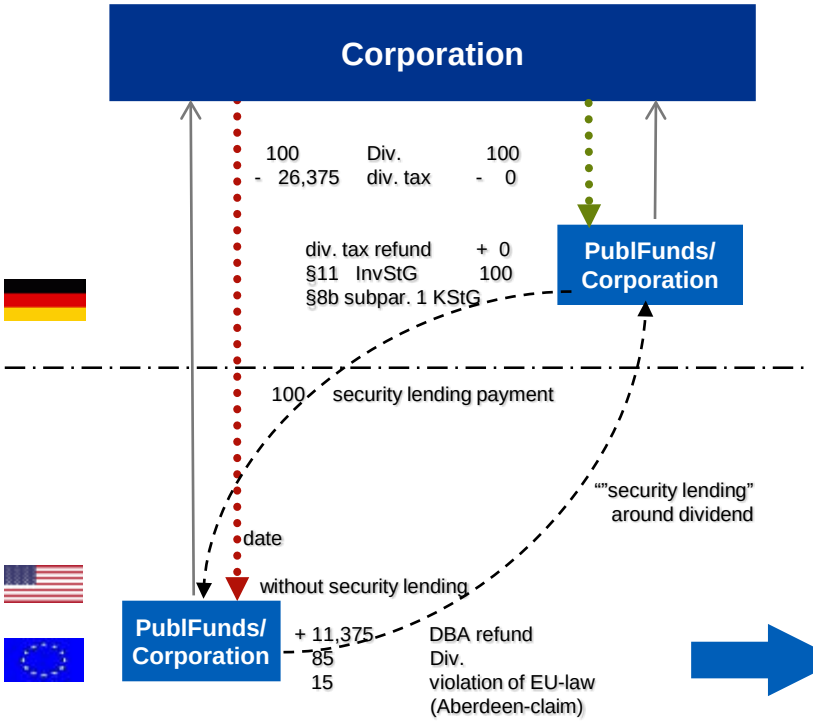
- Pending proceedings can be put on hold until the test case is settled
- Tax office competency agreements eliminates risk of non-compentent tax office and thus invalid claim only for the single case the agreement refers to
- Claims are to be made to the competent tax authority in whose jurisdiction the client has his most valuable investments (valuation and deadline uncertain) according to §20 subparagraph 3 AO

Other model cases which are work in progress:

- Several years of negotiation (4/7/10/13): Statue of limitations acoording to principle of equivalence
- Three and more country cases
- EU-members France (FCP & SICAV), Belgium (SICAV) und the UK(OEIC)
- Third countries (non-EU member) USA (RIC) and Canada (OEIF)

III. „Cum-Cum-Deals", as unlawful deals according to §36a EStG

1. §36a EStG violation of EU-law – no basis!



EU-law violation by §36a EStG

§36a EStG eliminates security lending/ selling if transaction takes place within 45 days around the dividend date by not allowing a dividend tax refund.

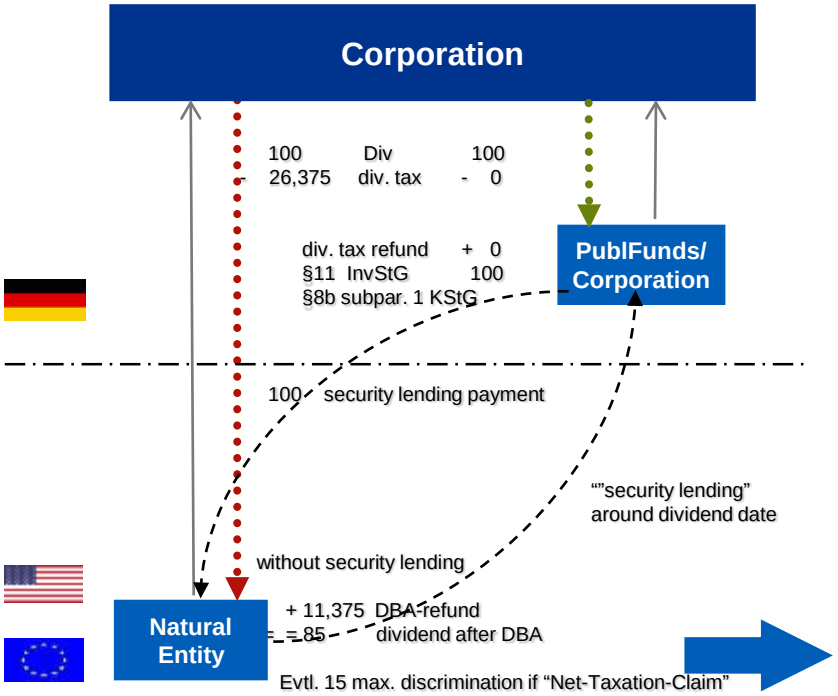
If lender/ seller has an EU-law protected dividend tax refund claim, §36a EStG restricts Art. 63 AEUV without justification.

-> Violation of freedom of capital transactions

To hamstring primary law refund claims cannot be justified with the EU-law!
Only EU-law regulated domestic taxation claims justify constraints!

“Cum-Cum Transaction” eliminates discrimination!

2. §36a EStG violation of EU-law – disproportionate!



Violation of EU-law by §36a EStG

§36a EStG eliminates security lending/ selling if transaction takes place within 45 days around the dividend date by not allowing a dividend tax refund.

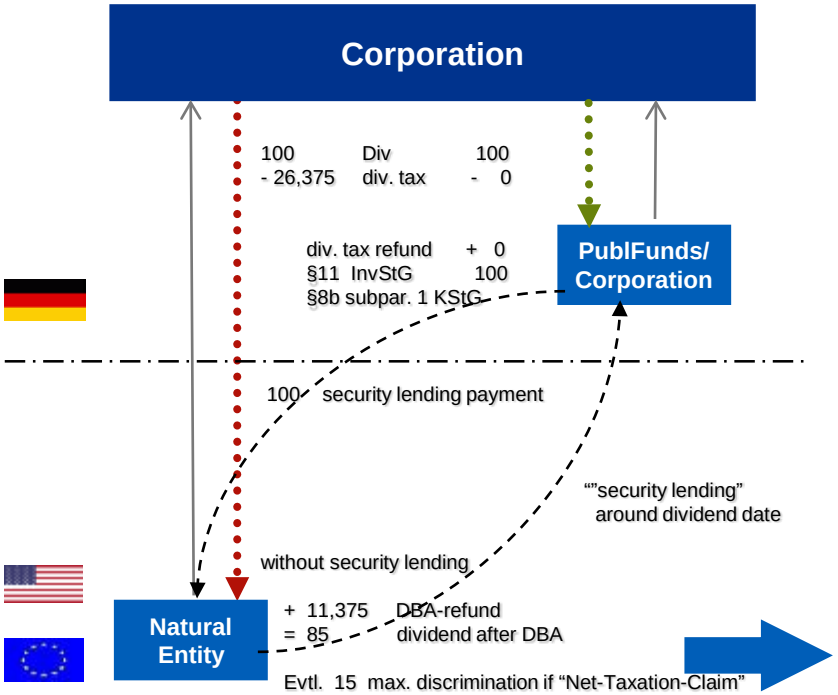
Even if lender/ seller does not have an EU-law protected dividend tax refund claim, the 45 day time limit of §36a EStG restricts the freedom of capital transactions (Art. 63 AEUV) disproportionately.

-> Violation of freedom of capital transactions

45 day rule is appropriate to fight illegal refund claims, but is disproportionate since after 10 or more days after the dividend date other motives exceed the corporate tax refund motive.

“Cum-Cum”-regulation contravenes EU-Law due to Disparity of Means!

3. §36a EStG EU-law conformity – proportionate!



Violation of EU-law by §36a EStG

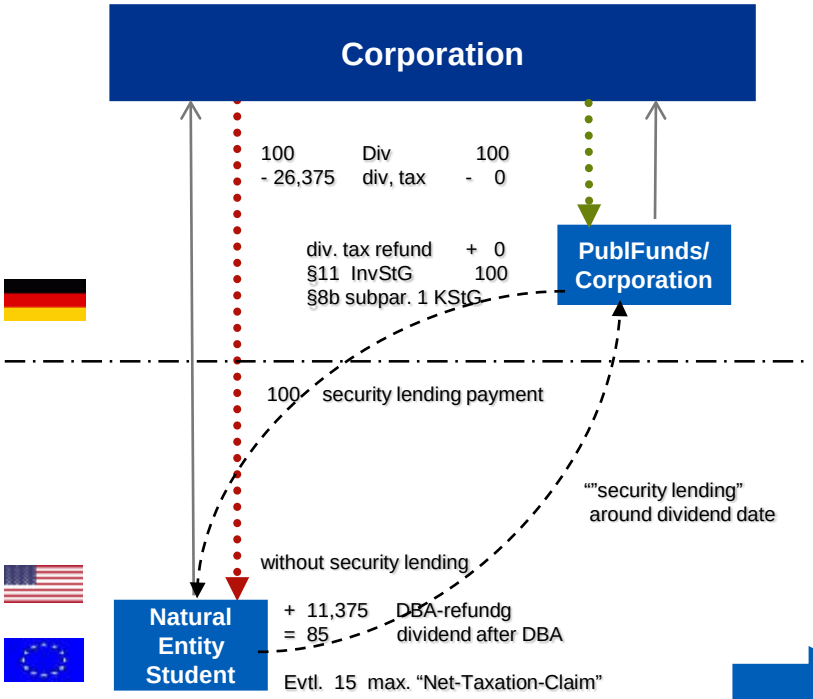
If a rule eliminates the security lending/selling within 10 days around the dividend date by not allowing a dividend tax refund, the constraint of the freedom of capital transactions according to art. 63 AEUV is justified and proportionate

-> No violation of art. 63 AEUV

A 10 day time limit to fight illegal refund claims is appropriate and proportionate as tax reduction motives are most likely the main motive within 10 days around the dividend date.

“Cum-Cum-regulation” proportionate and secures German tax income, if Net-Taxation-Claim would not be possible!

4. Proposal EU-law conformity of §36a subpar.2 S. 1 EStG



§36a subpar. 2 S. 1 EStG EU-law conformity:

"The minimum period of ownership is 10 days and has to be maintained within 10 days prior and 10 days after the maturity of the earnings.

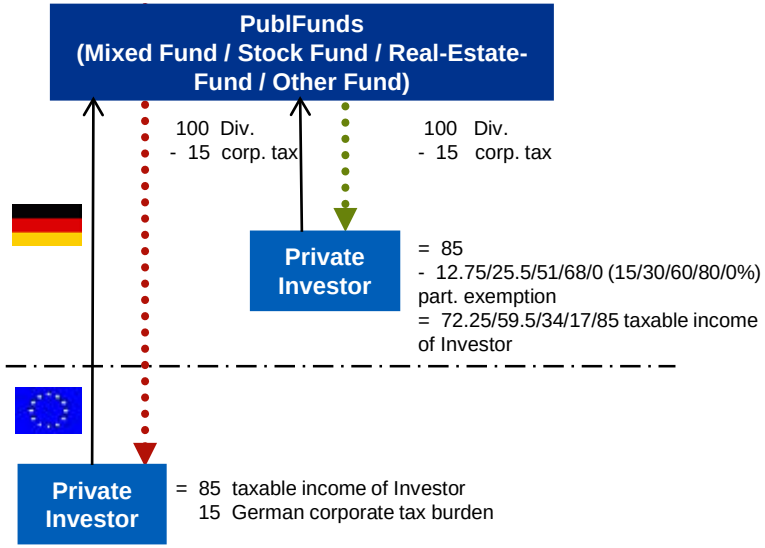
§36a subpar. 8 EStG EU-law conformity:
The above mentioned paragraphs are not to be used, if the lender/ seller of the security himself has a claim for a refund, or an actual or potential exemption of a dividend taxation. Such a claim includes especially the claims that arise due to the Treaty on the Functioning of the EU (AEUV), the Agreement on the European Economic Area (EWR), or other agreements based on the EU."

Ficticious change of "Cum-Cum-regulation" would allow security lending or Net-Taxation-Claim alternatively!

IV. Discrimination of Investment Funds with non-German investors under the new Investment Tax Act 2018 (under the so called German car-toll-considerations)

1. „Foreigner corporate tax" §§6, 20 InvStG 2018

To simplify graphic does not include dividend taxes!



Initial situation

German dividend earnings from funds taxed with a 15% corporate tax according to §6 InvStG 2018.

-> Equal treatment at fund level

Problem

Staggered partial exemptions for German investors compensates for a prior charge.

No compensation for foreign investors.

Same discrimination as the currently suspended German car toll (PKW-Maut)

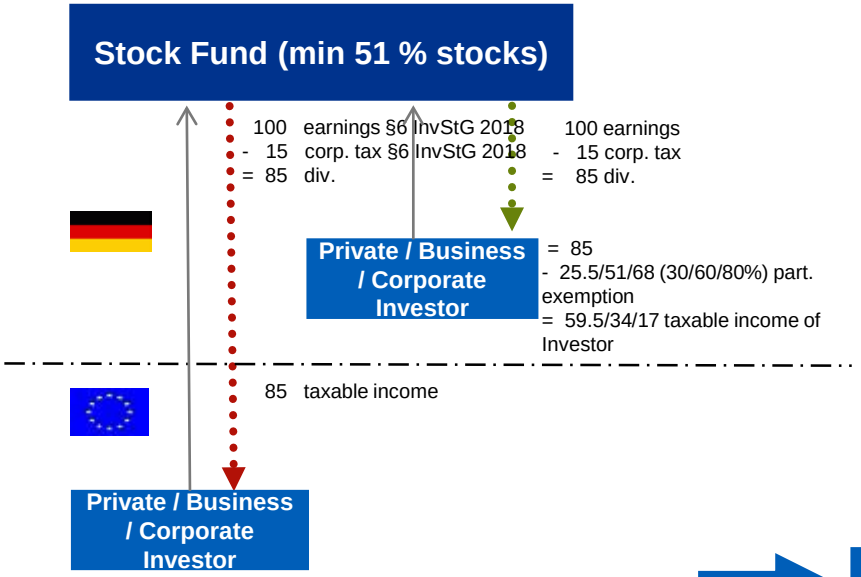
Discriminating against investors!

1. „Foreigner corporate tax" §§6, 20 InvStG 2018

Further disadvantages

- Only „Riester, Rürup, non-profit, church and foundation- investors receive partial corporate tax exemptions
- Other foreign investors indirectyl have to pay corporate taxes since no partial exemption is granted
- Attempt to justify this action claims that partial exemption can only be granted by the respective countries themselves, but fails to consider that the same justification would apply for the German car toll (foreign governments should pay the costs of German freeways) and was not accepted by the European Commission
- Disadvantages of investing into funds vs. direct investments -> public funds unattractive
- 15% corporate tax instead of variable taxation of direct investments according to generated earnings

2. Example of „foreigner corporate tax"



Issue

German dividend earnings of equity funds are taxed according to §6 InvStG 2018 at a rate of 15%, since domestic investors receive a 30% partial exemption according to §20 InvStG 2018 their corporate tax is compensated at domestic investor level.

Foreign investors on the other hand are charged with the ("foreigner") corporate tax.

Consequence:

-> Discriminating against foreigners

Discrimination: 15

. 2. Example of „foreigner corporate tax"

Discrimination similar to car toll issue

- Foreign investors are definitely charged with a 15% corporate tax according to §6 InvStG 2018, while domestic investors are compensated through their partial exemption of their earnings from their taxable income
- The European Commission viewed the comparable German car toll as a violation of the Treaty on the Functioning of the EU (AEUV) as only domestic drivers were compensated for the toll.
- Foreign investors are definitely charged with a 15% corporate tax with the striking attribute of it being the focus on foreigners. For the car toll the European Commission has indicated dropping the lawsuit for contract breach in case the charge is NOT linked to the driver being a foreigner, but rather to other factors, such as environmental factors.

Recommendation: Investment Funds with foreign fund unit holdes should file „Car-toll-claims" starting 2018

KPMG

Thank you very much.

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We kindly invite you to a brunch in the Atrium